

## ANALYSIS OF AMENDED BILL

Author: Campbell Analyst: Marion Mann DeJong Bill Number: AB 1976

Related Bills: \_\_\_\_\_ Telephone: (916) 845-6979 Amended Date: 05/05/98

Attorney: Doug Bramhall Sponsor: \_\_\_\_\_

**SUBJECT:** Manufacturers' Investment Credit/Excess Credit Refundable Over 3 Years

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended \_\_\_\_\_.

☒ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended \_\_\_\_\_.

FURTHER AMENDMENTS NECESSARY.

☒ DEPARTMENT POSITION CHANGED TO Board, no position.

☒ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED February 17, 1998, STILL APPLIES.

OTHER - See comments below.

### SUMMARY OF BILL

This bill would allow any excess Manufacturers' Investment Credit (MIC), including prior year carryovers, to reduce the taxpayer's current year tax liability, with any remaining balance to be refunded in three equal installments over the following three years. The bill would also declare the Legislature's intent to appropriate funds for the refunds.

### SUMMARY OF AMENDMENT

The May 5, 1998, amendments added the refundable MIC provisions to the Personal Income Tax law (PITL), clarified how the MIC, including prior year carryovers, would be refunded and added refundable credits to the Bank and Corporation Tax law (B&CTL) hierarchy (Section 23036).

These amendments addressed the third through the seventh bullets under implementation considerations raised in the department's analysis of the bill as introduced February 17, 1998. Except for the Effective Date, Legislative History and current law discussion of the Specific Findings, the department's prior analysis is replaced with the following.

### DEPARTMENTS THAT MAY BE AFFECTED:

\_\_\_ STATE MANDATE

\_\_\_ GOVERNOR'S APPOINTMENT

#### Board Position:

\_\_\_ S      \_\_\_ O  
\_\_\_ SA    \_\_\_ OUA  
\_\_\_ N      X NP  
\_\_\_ NA    \_\_\_ NAR  
\_\_\_\_\_ PENDING

#### Agency Secretary Position:

\_\_\_ S      \_\_\_ O  
\_\_\_ SA    \_\_\_ OUA  
\_\_\_ N      \_\_\_ NP  
\_\_\_ NA    \_\_\_ NAR  
DEFER TO \_\_\_\_\_

#### GOVERNOR'S OFFICE USE

Position Approved \_\_\_\_\_  
Position Disapproved \_\_\_\_\_  
Position Noted \_\_\_\_\_

Department/Legislative Director      Date  
**Johnnie Lou Rosas**      **5/7/98**

Agency Secretary      Date

By:      Date:

#### SPECIFIC FINDINGS

**This bill** would delete the MIC carryover provisions and replace them with refund provisions.

**The bill** would allow the MIC, including prior year carryovers, in excess of "tax" or "net tax" to reduce the taxpayer's current year tax liability (as if it were a normal overpayment of tax), with any remaining balance to be refunded in three equal installments over the following three years.

**The bill** would require the taxpayer to affirmatively request each refund installment on the tax return filed for the year the installment is to be paid. Each refund installment would be credited against any amount due from the taxpayer (as if it were a normal overpayment of tax).

**The bill** would specify that interest may be allowed or paid pursuant to current law as if that refund installment were a current year overpayment. However, the amount of any interest allowed or paid cannot exceed the amount computed from the later of the due date of the return of the qualified taxpayer for that refund installment or the date on which the qualified taxpayer files the return requesting that refund installment.

**The bill** would specify that refunds would be paid to (1) successors to a corporation in the case of a reorganization, merger or consolidation; (2) shareholders of a corporation in the case of a dissolution; and (3) partners in the case of a termination of a partnership.

**This bill** would specify that taxpayers may not amend prior year returns changing the order of credits claimed to increase the amount of MIC carryovers eligible for this refund.

**This bill** would allow refund installments to continue to be made if the MIC were repealed, pursuant to the law as it read immediately prior to its repeal (Sections 17039 and 23036).

**This bill** also would add refundable credits to the hierarchy of B&CTL tax credits (Section 23036).

#### Policy Considerations

This bill would raise the following policy considerations.

- Critics of the current law MIC argue that the credit is useless since the taxpayer may not have sufficient tax liability within eight years (or ten years) to use the credit before the carryover is lost. This bill would resolve that concern by refunding the credit when there is not sufficient tax liability to use it. On the other hand, the MIC was enacted rather than a sales tax exclusion to reduce the overall cost of the tax benefit, since it was understood that credits frequently are not fully utilized.
- Historically, refundable credits (such as the state renter's credit, the federal Earned Income Tax Credit and the federal farm gas credit) have had significant problems with fraud.

### Implementation Considerations

This bill would raise the following implementation considerations. Department staff is available to assist the author with any necessary amendments.

- The department has not administered a refundable tax credit under the PITL since the renter's credit was suspended in 1993. The department has never administered a refundable tax credit under the B&CTL. Establishing a refundable tax credit program would have a significant impact on the department's programs and operations and require extensive changes to forms and systems.
- Because of the complexity of the refund provisions and the potentially significant refund amounts, it is expected that the department would manually review the returns requesting refund installments before refunds are issued. However, since complete audits could not be conducted within the normal return processing timeframes, refunds would be issued prior to audit. Disputes between taxpayers and the department could arise if upon audit (several years later) the taxpayer is asked to repay any incorrect refund amounts (with interest).
- It is unclear how the refund provisions would apply to estimated tax payments and underpayment of estimated tax penalties.
- Refunding the MIC over a three-year period increases the complexity of implementation, especially in the case of dissolving entities. Further, it is unclear whether the refund would be recaptured if the successor did not continue the manufacturing activity, ceased to use the qualified property in a qualified activity or removes the property from this state.
- Because of the use of the terms "net tax" and "tax," the MIC provisions (Sections 17053.49 and 23649) would require the taxpayer to utilize the MIC against tax *before* any other credits while the credit hierarchy provisions (Sections 17039 and 23036) would require the taxpayer to utilize the MIC against tax *after* certain other credits. The renter's credit uses the term "tax liability under this part" so that the renter's credit is used after other credits.
- Since this bill would delete the MIC carryover provisions and replace them with refund provisions, the department would consider the MIC to be a credit with only refundable provisions. However, since the MIC refund provision references prior year carryovers, taxpayers could consider the MIC to be a credit with both carryover and refundable provisions. This could cause disputes between taxpayers and the department, specifically in regards to the order of credits.

### Technical Considerations

- Amendment 1 would change "provision" to "provisions."
- Amendments 2 and 3 would modify the language that requires the Franchise Tax Board to determine the order of credits within each category to match the provisions of Section 17039.

### FISCAL IMPACT

#### Departmental Costs

Based on a preliminary analysis of this bill, it is estimated that departmental costs for programming and systems changes to implement this bill would exceed \$1 million for 1998-99. It is estimated that costs for processing refund requests and issuing refunds in the first year (1999-00) would be approximately \$500,000, with ongoing annual costs of approximately \$1 million per year beginning in 2000-01. This estimate does not include costs for processing and refunding prior year carryover amounts since data regarding the number of returns with prior year carryovers are not currently available. Department staff will refine and update these costs as the implementation considerations are resolved.

#### Tax Revenue Estimate

The estimated revenue impact of this bill is shown in the following table:

AB 1976 As Amended May 5, 1998 Refunds for Tax Years Beginning on and After January 1, 1998 \$ Millions			
1998-99	1999-00	2000-01	2001-02
(\$15)	(\$580)	(\$720)	(\$850)

This analysis does not take into account any change in employment, personal income, or gross state product that may result from this bill becoming law.

#### Tax Revenue Discussion

The revenue impact of this bill would be determined by the extent that credits exceed the liability remaining after unused credit carryovers from prior years are applied against liability for tax years beginning on and after January 1, 1999.

This estimate was calculated from tax returns for the 1995 and 1996 tax years and U.S. Department of Commerce data for manufacturers' investment in plant and equipment projected to be placed in service in California. This estimate assumes that unused credits could be used on 1998 returns to offset other liability (minimum taxes mostly) and that refunds would be issued beginning with the 1999 returns.

The revenue losses are 89% for B&CTL and 11% for PITL.

BOARD POSITION

No Position.

At its March 26, 1998, meeting, the Franchise Tax Board considered this bill as introduced February 17, 1998, but took no position. Julie Bornstein, on behalf of Controller Kathleen Connell was neutral, Member Dean Andal was opposed, and Robin J. Dezember, on behalf of member Craig L. Brown, abstained.

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FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO AB 1976  
As Amended May 5, 1998

AMENDMENT 1

On page 20, line 8 strikeout "provision" and insert:

provisions

AMENDMENT 2

On page 20, strikeout lines 11 and 12 inclusive and insert:

taxable years

AMENDMENT 3

On page 20, strikeout lines 18 through 21 inclusive and insert:

(6) Credits that contain refundable provisions but do not contain carryover provisions.

The order of credits within each paragraph shall be determined by the Franchise Tax Board